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FINANCING MICROENTERPRISES: LESSONS LEARNED FROM THE A.I.D. STOCKTAKING

by

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Abstract

This paper summarizes the key results of the analysis recently conducted as part of A.I.D. Stocktaking of its microenterprise projects and programs. A total of 32 programs in 20 countries were reviewed. The programs were divided into three types: enterprise formation, enterprise expansion, and enterprise transformation. The results include key variables such as average number of annual beneficiaries, average cost per beneficiary, average loan size, average program cost per dollar lent, average real interest rate and percent of loan funds in arrears. The financial institutions that operate enterprise expansion programs represent a clear subgroup as they reach thousands of clients and make mostly working capital loans. Most programs require subsidies but the enterprise expansion programs come closest to self-sufficiency. The key issues facing designers of microenterprise projects is the number of clients to be reached, policy regarding cost recovery, and extent to which the program will strive for self-sufficiency.

FINANCING MICROENTERPRISES: LESSONS LEARNED FROM THE A.I.D. STOCKTAKING[1]

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INTRODUCTION

Microenterprise development is a subject of great interest in the foreign assistance field. Although there has been a longstanding interest in the related subjects of small scale enterprises, rural nonfarm enterprises, and cottage industries, the nagging issues of unemployment, underemployment, and poverty have prompted a reassessment of possibilities for assisting the poor to start and expand their own businesses. The great publicity about the reported success of the Grameen Bank in Bangladesh in providing loans to thousands of very poor rural people, and doing so in a sustained fashion, has contributed to the enthusiasm about assisting microenterprises.

Assistance to microenterprises can take many forms. A common element of many programs is credit, either alone or in conjunction with training and technical assistance. There is a widespread belief that the crucial constraint facing the poor is adequate credit to start or expand businesses. Dr. Muhammad Yunus, founder of the Grameen Bank, clearly makes this point as his basic rationale for starting the original Grameen Program which eventually evolved into the current Bank. Other observers doubt that credit is really the key constraint because many problems faced by a firm, such as high cost operations, excessive inventories and poor sales, tie up working capital and make it

[1] The author wishes to thank Jim Boomgard for clarifications on an earlier draft. The usual disclaimers apply.

appear that credit is the constraint. But even if improved access to credit is only one of the needs of microenterprises, the challenge is to find an appropriate financial system to serve microenterprises without repeating the same mistakes that were so frequently committed around the world when governments and aid agencies tried to channel more institutional loans to small farmers. The credit targets, quotas, subsidized interest rates, and specialized credit agencies that were implemented for small farmers have now been thoroughly documented as responsible for the demise of many financial institutions, the concentration of subsidized loans in the hands of the privileged few, the expectation among many borrowers that loans obtained from the government or donors don't have to be repaid, and the failure to effectively mobilize rural savings.[2]

To avoid repeating the mistakes of the small farmer credit experience, it is necessary to proceed with great caution in developing policies and programs to finance microenterprises. A key step in the process should be a careful analysis of the several programs that have functioned for some time in several countries, so each country can learn what has worked and what has not in similiar circumstances elsewhere.

The U.S. Agency for International Development (A.I.D.) has been heavily involved in microenterprise projects and programs in several countries. It recently undertook a systematic study of its' experience referred to as Microenterprise Stock-Taking. A synthesis report is now available which summarizes the results (Boomgard). The purpose of this paper is to extract and discuss some key findings of the report (hereafter referred

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[2] The difficulties experienced in the Philippines in trying to rapidly expand small farmer credit in the early 1970s are well documented in several publications. A useful summary can be found in Sacay et. al. Other general references include Adams, et al.; Donald; Howell; and Von Pischke, et al.

to as the MST report). The comprehensive nature of the analysis provides useful insights for everyone working in the microenterprise field. The analysis included in the MST report is broad, but this paper is limited to those results that are particulary relevant for financing microenterprises.

DESCRIPTION OF THE STUDY[3]

The objectives of the Stock-taking were to determine which approaches to microenterprise development are most consistent with A.I.D.'s program goal of broad based economic growth and to understand the conditions that govern the choices among competing strategies. It focused on identifying projects and programs that have proved effective in generating and sustaining developmental benefits, and in analyzing the factors responsible for their successful performance. Throughout the study, microenterprises were operationally defined as firms that employ 10 or fewer full-time workers.

A purposive sample of 32 projects and programs located in 20 countries was selected for detailed study from A.I.D.'s total portfolio of at least 87 active field projects or programs in 35 countries. They were selected because, to a greater or lesser extent, they targeted assistance to microenterprises, and some analysis of beneficiary impact was available. Data analyzed in the study were obtained from existing evaluations and site visits to 10 countries. The complete sample is listed in Table 1 along with some key characteristics of each. In almost all cases, the project or program either began operations in the 1980s or A.I.D.'s involvement began at that time. The sampled programs,

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[3] Except where specifically noted, the following material was abstacted from the MST report.

therefore, reflect much of the learning that has taken place in this field in the past several years. As noted in Table 1, 7 observations were drawn from Asia, including the large scale Indonesian BKK program, 11 from Africa, and 23 from Latin America. They are being implemented by PVOs, government agencies and credit unions. Some provide only credit to their beneficiaries, while others also provide training and technical assistance.

Three distinct approaches to enterprise development were identified in the study and these approaches were used as the basic conceptual framework around which the empirical analysis was conducted. The **enterprise formation approach** aims to integrate highly disadvantaged groups or individuals from the survival economy into the micro-economy. They are sometimes referred to as community development programs because their enterprise development work is frequently embodied in a broader social development program. They often serve a relatively large proportion of new entrepreneurs and offer a comprehensive range of services focused on the creation of rudimentary business skills. Much of the direct benefit is in the form of income generation rather than in employment.

The **enterprise expansion approach** tries to improve the performance of micro-enterprises. It is essentially marginalist because it emphasizes small, achievable improvements across a relatively large number of firms. Any graduation of firms into small enterprises is governed more by natural selection than by project effort. Many of these programs have evolved towards a minimalist credit-only orientation to reduce operational costs.

The **enterprise transformation approach,** however, actively tries to graduate its clients from micro to small enterprises. These programs often provide an integrated mix of credit, training, and technical assistance to a select group of clients. Screening is generally based on project feasibility and participation in the training program. The firms selected are typically somewhat larger than those assisted through the other approaches so employment generation plays a relatively larger role in the project benefits.

In a sense, both the formation and transformation approaches are transformation-oriented, and this explains their relatively heavy emphasis on technical assistance and training, and their inherent pateralism. The expansion approach tries to support and enable the existing enterprise, and this accounts for the credit orientation of the marginalist approach.

The sampled projects and programs were distributed among these three approaches as shown in Table 2. Six were found to emphasize enterprise formation, 22 enterprise expansion, and 14 enterprise transformation. Because of multiple subprojects, the total number exceeds the total sample size. The most noteable differences in geographic distribution of type of program is the relatively small proportion in Latin America that emphasize formation, and the relatively large proportion in Asia and the Near East that fall in the expansion category.

The performance of the sampled programs was evaluated on three criteria: beneficiary impact, cost-effectiveness, and institutional sustainability. The first proved difficult to measure because of the lack of comprehensive data. Sustainability was evaluated on the three dimensions of financial, organizational and environmental sustainability.

SUMMARY RESULTS OF THE STUDY

The principal empirical results of the MST report are summarized in Table 3. Several general descriptive features are presented in the top portion of the Table, while information on financial characteristics is presented at the bottom. The enterprise expansion data are presented in columns three, four and five. Column two gives the results calculated for all the enterprise expansion programs treated together. However since the group is heterogeneous, the results for the six programs which primarily operated as financial institutions are presented separately in column three, and the results for the remaining programs are summarized in column four. Column six indicates if the differences in the reported means among the groups is statistically significant at the 5% level. In several cases many of the programs did not report data for some characteristics studied. In other cases there was wide variance among the programs within a particular group. Therefore, some of the differences in mean values appear large but are not statistically significant. Complete data for all programs or a larger sample might confirm that these apparent differences are in fact significant.

Most of these programs, with the exception of the financial institutions, have been operating for only a few years. There are at least three implications of this fact. First, these programs may be superior than some older programs because they have incorporated improvements learned from previous experience. Second, some programs have experienced large start-up costs which may inflate their current cost estimates. But there is another issue, not discussed in the MST report. Frequently credit programs look good during the first few years of their operation when funds are flush, when personnel are enthusiastic, and when the donor spotlight is on them. Later when funds have eroded due to delinquency and inflation so repeat loans cannot be made to clients, the recovery rate declines, the portfolio shrinks, and costs per client soar. Therefore, it is not clear if these results represent an over- or an underestimation of expected long run costs and sustainability.

Most programs serve only a few hundred clients; the exceptions are the financial institutions that serve thousands. Women represent a significant share of total program beneficiaries in all programs. There is a tendency for the formation and transformation programs to serve a larger percentage of manufacturing firms compared to other types, but the differences are not significant. Average program costs also are higher, but not significant, for formation and transformation programs as would be expected with the larger amount of training and technical assistance they tend to provide to their clients compared to the expansion programs.

There are significant differences in size of loans granted to clients. The average loan size in transformation programs exceeded $3,000 compared to approximately $500-700 in the other programs. This finding suggests that attempts to graduate microenterprises to small scale firms requires a large enough change in the firm to justify a relatively larger loan than granted in the other programs. It also suggests that transformation programs assume their clients have the ability to manage a larger loan. The relative size of loan can be seen by comparing average loan size relative to GDP per capita. The transformation programs provide loans on average that are ten times the average GDP per capita compared to the other programs which provide loans roughly 1 to 2 times GDP per capita.

Most programs provide 25 to 45 percent of their loans to finance fixed assets. The financial institutions in the expansion programs, however, distinguish themselves by providing mostly working capital loans. This is consistent with their objective of helping their clients make marginal inmprovements in their businesses. By lending mostly working capital, these institutions also face less stringent staff requirements, so it is easier for them to operate large scale institutions that reach thousands of clients. Fixed asset loans that finance clients to make significant changes in their firms require more skilled manpower to engage in business analysis and loan appraisal, and provide technical assistance to borrowers.

Cost-effectiveness and financial sustainability are issues that all programs face in their operations. The range of services provided to clients and the policies employed regarding charging fees and interest rates determine the success that programs have in covering their operational costs. The data in the bottom three lines of Table 3 give some indication of the comparative performance of these programs in these areas. Because of the more modest services they provide and the large scale of their operations, the average program cost per dollar lent is lowest for the expansion programs with an average of just under $0.50. Transformation programs on average cost double that amount, while formation programs cost six times more. These are necessarily approximate figures because of the different ways that the programs account for costs not directly associated with credit.

One good indication of a program's ability to recover costs is reflected in the interest rate charged on its' loans. The difference in the policies of the programs on this crucial variable can be seen in the average real interest rates (nominal interest rate minus inflation) reported in Table 3. The expansion programs charge rates that average up to 25 percent, while the other programs have a large subsidy element because they only charge their borrowers 0 to 3 %. Even the relatively high rates in the expansion programs do not cover the program costs discussed just above however.

The challenge to recover costs is further complicated by the problem of loan delinquency and default. The data in Table 3 show that all programs on average report a percentage of loan funds in arrears ranging from 16 to 24 percent. Assuming that only half of these actually result in loan losses still implies losses of 8 to 12 percent, a level which is hard for any program to sustain without continuous transfusions of outside funds. Therefore although these programs may strive for financial self-sufficiency, it it clear that on average they do not charge interest rates high enough to cover operating costs, inflation and reserves for bad debts. The expansion programs come closest to meeting this objective, but generally the other programs are far it.

The MST report notes that financial self-sustainability is closest to being achieved in the best managed programs which limit their assistance to low cost financial services. These include ADEMI in the Dominican Republic, the BKK and KUPEDES programs in Indonesia, and the CAMCCUL credit union system in the Cameroon. Long term institutional survival and a sustained flow of services in most programs is achieved through a combination of earnings, philanthropy, government budget appropriations, and donor assistance. Importantly, it was observed that credit programs that strive to become self-sustaining, even when the goal is unattainable, generally perform better than programs that are managed with the expectation of continuing external support.

Organizations that think of themselves as businesses that live or die on the basis of earnings behave differently than if they are not subjected to this market test.

CONCLUSIONS AND IMPLICATIONS

The MST report concludes that direct assistance programs that aim to improve the performance of microenterprises without attempting to transform them into more complex businesses have a better record of achievement than do more ambitious transformational programs. They typically provide small working capital loans with efficient screening, rapid disbursement and a reasonable assurance of the availability of larger loans upon repayment. The beneficiaries are poor, but not the poorest of the poor. Benefits of the programs are modest for each client, but reach many clients in the form of increased income rather than through large amounts of employment creation. The organizations implementing these programs set out to establish financially self-sustaining credit systems. As a result, they adopt a businesslike attitude towards achieving a large volume of lending and operate in a market area large enough to achieve economies of size. It is interesting that many of these characteristics reflect the objectives and operations of the Grameen Bank, and perhaps help explain its success.[4]

The results of the MST study suggest to this author that countries and donors face several issues in deciding how to design and implement a microenterprise support program. They include the following:

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[4] A comprehensive analysis of the Grameen Bank can be found in Hossain.

1. What is the primary objective of the program? Is it to increase the income of the clients, or is it to create new employment? The MST report suggests that it is necessary to have this objective clear at the outside because the program design and the services provided may be quite different depending of the objective.

2. How many clients are to be reached? Is the objective to reach large numbers with a marginalist approach, or to provide a great deal of assistance to a few clients so they can make a large change in their firms? The programs studied had quite different objectives on this point and this conditioned staffing, budgets, and organization.

3. What policy will be employed regarding cost recovery from the clients? Will interest rates be set high enough to cover operating costs, risks and inflation, or will they be highly subsidized in order to increase the benefits to the borrowers? Will fees be charged for noncredit services? Will part of the capital be provided in the form of grants rather than loans when there is a high probability that the clients will not be able to repay?

4. Should the program strive for financial self-sufficiency so that it can become a reliable source of services to its clients, or should it expect to continuously seek external support from government and donors, and adjust its program and services to the amount of funds received? If self-sufficiency is expected, how long is it expected to take to reach after the state-up date?

A final issue not discussed in the report concerns the mobilization of savings from clients assisted by financial institutions. Many financial programs are designed on the assumption that the clients are too poor to save. This leads to one-sided institutions that provide only loans, and don't mobilize savings. It is now clear that there is much greater saving capacity in rural areas than previously assumed, and these savings can be mobilized if correct policies are followed. In spite of being a lending program for the poor, the Grameen Bank is mobilizing significant amounts of deposits from its borrowers in the form of voluntary and compulsory savings. Other programs could do more to self-finance their operations if they would pay more attention to the savings potential of their clients. Furthermore, the provision of deposit and savings services would represent another useful service provided to their clients.

The benefits of microenterprise programs for the poor are fairly well documented in the MST report. The characteristics of the different programs and the factors which contribute to their success are even better understood. The fundamental issue to be asked as each country develops its microenterprise program is whether it wants to reach a few hundred or several thousand clients. The answer to that question will go a long way toward shaping the characteristics, the operations and the costs of the program.

Table 1: Projects/Programs Reviewed in the Evaluation - Summary Characteristics

Nbr	Country	Project/Program Name	Acronym	Beginning of A.I.D. Involvement	A.I.D. Funding ($1,000)	Implmtng. Inst. Type	Source of Ext. TA	Developmental Approach	Services to Enterprises	Des Fie Rev
Asia and Near East										
1	Bangladesh	Women's Entrepreneurship Development Project	WEDP	1982	877	Govt	None	F	Credit/TAT	D
2	Indonesia	Fin Inst Dev Project	FID	1986	13,745	---	---	--	---	--
2A		FID/Badan Kredit Kecamatan	FID-BKK	1986	ND	Govt	DAI	E	Credit	D F
2B		FID/KUPEDES	FID-KUPEDES	1986	ND	G-Bank	HIID	E	Credit	D F
3	Indonesia	CJEDP - Rattan Export Development Program	CJEDP-R	1985	1,400	G-Project	DAI	T	TAT,Policy	D
4	Indonesia	Puskowanjati Women's Cooperative	PWC	1984	505	Coop	None	E	Credit/TAT	F
5	Indonesia	Maha Bhoga Marga Foundation	MBM	1987	179	I-PVO	OI	E	Credit	F
6	Egypt	CEOSS Income and Employment Generation Project	CEOSS	1983	313	I-PVO	None	F	Credit/TAT	F
7	Egypt	Helwan Project Small Enterprise Loan Program	SELP	1982	181	G-Project	CHF	E	Credit	F
Africa										
8	Burkina Faso	PfP Rural Enterprise Development Project	REDP	1977	2,467	US-PVO	PfP/CID	F	Credit/TAT	D
9	Cameroon	Cameroon Co-operative Credit Union League	CamCCul	1975	4,800	C-Union	WOCCU	E	Credit	F
10	Chad	Chad Private Enterprise Project I & II	CPEP	1984	2,051	US-PVO	VITA	T	Credit/TAT	D
11	Kenya	Nat Council of Churches Kenya - Small Bus Scheme	NCCK-SBS	1981	275	I-PVO	None	F	Credit/TAT	D
12	Liberia	Nimba County Rural Technology Project	NIMBA	1980	4,264	US-PVO	PfP	E	Credit/TAT	D
13	Malawi	Rural Enterprise & Agribus Dev. Institutions	READI	1984	---	---	---	---	---	---
13A		READI-Malawi Union of Savings and Credit Coop.	MUSCCO	1984	1,388	C-Union	WOCCU	E	Credit	F
13B		READI-Development of Malawian Traders Trust	DEMATT	1987	760	Govt	PfP/Africare	T	TAT	F
14	Senegal	Community and Enterprise Development Project	CEDP	1985	9,000	G-Project	---	--	---	---
14A		Small-Scale Enterprise Component	CEDP-SSE	1985	ND	G-Project	NTF	T	Credit	D F
14B		Village Organization Component	CEDP-VO	1985	ND	G-Project	NTF		Credit/TAT	D F

TAT: Technical Assistance and Training
I-PVO = Indigenous Private Voluntary Organization
A-PVO = Affiliated Private Voluntary Organization
US-PVO = U.S. Private Voluntary Organization
L-PVO = Latin Private Voluntary Organization

G-Bank = Government Bank
G-Project = Government Project
Gov't = Government
C-Union = Credit Union
ND = No Data
--- = Not relevant

T = Enterprise Transformation Approach
E = Enterprise Expansion Approach
F = Enterprise Formation Approach
D = Desk Study Review
F = Field Review

Mbr	Country	Project/Program Name	Acronym	Beginning of A.I.D. Involvement	A.I.D. Funding ($1,000)	Implmtng. Inst. Type	Source of Ext. TA	Develop-mental Approach	Services to Enterprises	De: Fi(Re\
Latin America										
15	Belize	National Development Foundation of Belize	NDF-B	1983	336	I-PVO	PADF	T	Credit/TAT	D
16	Colombia	Banco Mundial de la Mujer	WWB-BMM	1982	ND	A-PVO	WWB	E	Credit/TAT	D
17	Costa Rica	Aid to Urban Ent Through a Solidarity Guarantee	EUS	1982	65	G-Bank	PISCES	E	Credit	D
18	Costa Rica	Women In Business Program	OEF-WIB	1985	ND	US-PVO	OEF	F	TAT/Credit	D
19	Dom. Rep.	Asociación Para el Desarrollo de Microempresas	ADEMI	1982	1,085	I-PVO	ACCION	E	Credit/TAT	D
20	Dom. Rep.	Asoc. Dom. Para el Desarrollo de la Mujer	ADOPEM	1982	ND	A-PVO	WWB	E	Credit	D
21	Dom. Rep.	Dominican Development Foundation - PRODEME	DDF-PRODEME	1980	500	I-PVO	PISCES	E	Credit/TAT	D
22	Dom. Rep.	Pro de Asist Peq Empre/Fondo Para el Desarrollo	PROAPE/FONDESA	1985	ND	I-PVO	None	E	Credit/TAT	
23	Ecuador	Small Enterprise Development Project	SEDP	1987	4,500	---	---	--	---	
24A		SEDP- Inst of Socio-Economic & Tech Research	INSOTEC	1987	1,900	I-PVO	None	T	TAT	
24B		SEDP - FEE and FED Component	FEE/FED	1987	ND	US-PVO	ACCION	E	Credit/TAT	
24C		SEDP - Carvajal Foundation Component	CARVAJAL	1988	ND	L-PVO	Carvajal	T	TAT/Credit	
25	Guatemala	Small Enterprise Assistance Foundation	FAPE	1984	ND	I-PVO	OI	E	Credit/TAT	
26	Guatemala	Women's Development Foundation	FDM	1981	305	I-PVO	None	T	Credit/TAT	
27	Guatemala	Found. for the Dev of Socio-Economic Programs	FUNDAP	1985	---	I-PVO	---	--	---	--
27A		FUNDAP - Momostenango Project	FUNDAP-M	1985	637	I-PVO	ATI	T	TAT	
27B		FUNDAP - Nahula Project	FUNDAP-N	1988	195	I-PVO	None	T	TAT	
27C		FUNDAP - Prog for the Support of Microent.	FUNDAP-P	1988	200	I-PVO	ACCION	E	Credit	
28	Honduras	National Development Foundation of Honduras	FUNADEH	1985	1,000	I-PVO	PADF	T	Credit/TAT	D
29	Honduras	Women in Business Program	WIB	1985	ND	US-PVO	OEF	F	TAT/Credit	D
30	Jamaica	National Development Foundation of Jamacia	NDF-J	1982	500	I-PVO	PADF	T	TAT/Credit	D
31	Paraguay	Fundacion Payaguaya de Cooperacion y Desarrolo	FPCD	1985	370	I-PVO	ACCION	E	Credit/TAT	
32	Peru	Urban Development Fund	UDF	1982	13,000	G-Bank	None	T	Credit	D

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Table 2

DISTRIBUTION OF PROGRAMS BY REGION

Region	Enterprise Formation		Enterprise Expansion		Enterprise Transformation	
	No.	%	No.	%	No.	%
Asia and Near East	2	25	5	62	1	12
Africa	2	20	4	40	4	40
Latin America	2	8	13	54	9	37
Total	6		22		14	

Table 3

KEY RESEARCH FINDINGS

Item	Enterprise Formation	Enterprise Expansion: Total	Enterprise Expansion: Financial Institution	Enterprise Expansion: Micro-Enterprise Program	Enterprise Transfor-mation	Statisti-cally Significant[a]
Average Years in Operation	3.7	4.0	7.3	2.7	2.3	yes
Average Number of Annual Beneficiaries	328	87,871	393,172	642	264	yes
Average Percentage of Women Beneficiaries	59	43	41	43	27	no
Average Percentage of Beneficiaries in Manufacturing	54	40	23	44	60	no
Average Program cost per Beneficiary ($)	948	575	N.R.	575	2,549	no
Average Loan Size ($)	508	705	676	714	3,261	yes
Average Loan to GDP per Capita	1.3	1.2	2.2	0.9	10.2	yes
Average Percentage of Fixed Assets Loans	25	20	9	26	45	no
Average Program Cost per Dollar Lent ($)	3.24	0.46	0.51	0.43	1.08	yes
Average Real Interest Rate	3	23	17	25	0	no
Percent of Loan Funds in Arrears (%)	24	17	22	16	18	no

[a] Statistically significant at the 5 percent level.

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